therefore that the 1957 lease should be classified as a factual background of the case known to the parties at or before the first lease was executed and therefore admissible in evidence, and the trial Judge was entitled to use it not for the purpose of construing the first lease but for showing inconsistency between the factual background and the claim of the appellant to perpetual renewals of the first lease (see *Citibank N.A.* v. *Ooi Boon Leong & Ors*[1 2]). In any event, it is our view that in the present case, the first lease on its face, is sufficient to construe clause 4(e) without the necessity to supplement it by extraneous evidence. Mr. Lim Kean Chye has taken the trial Judge to task for describing the words used in clause 4(e) as "mere legal jargon". We can only assume that the description refers to the fact that the words used were not clear, and in that context the learned Judge was correct. In the absence of explanatory words, they stood as mere legal jargon creating no right whatsoever to perpetual lease.

We dismiss this appeal with costs. Deposit to the respondent on account of taxed costs. We further order that costs of application for stay be taxed and paid to the respondent.

Appeal dismissed.

Solicitors: *Chooi & Co.; Sharma & Co.*

DIRECTOR-GENERAL OF INLAND REVENUE v. RAKYAT BERJAYA SDN. BHD.

[F.C. (Lee Hun Hoe C.J. (Borneo), Mohamed Azmi & Syed Agil Barakbah F.JJ.) October 3, 1983 & January 5, 1984]

[Kota Kinabalu – Federal Court Civil Appeal No. 142 of 1983]

Revenue Law – Assignment of rights and liabilities under timber concession – Consideration payable by instalments – Interest charged – Whether interest deductible – Income Tax Act, 1967, ss. 33(1) & 39.

In this case the Sabah Foundation had assigned its rights and liabilities under a timber concession obtained from the Sabah Government to the respondent Company. The consideration was $250,000,000 payable by 50 biennial instalments. The respondent company was also required to pay interest at the rate of 7% per annum from the date of the agreement on the sum of $250,000,000 or such part thereof as was outstanding. In computing the income liable to tax for the years of assessment 1972 – 1974 the Director of Inland Revenue, Sabah did not allow deduction for the interest paid in accordance with the agreement and for forest allowances on the capital expenditure incurred on the construction of the log pond and buildings. On appeal, the Special Commissioners allowed the deduction for forest allowance but rejected the deduction for interest. The learned Judge on a case stated disagreed with them in respect of the deduction of interest and allowed the deduction. The appellants appealed.

Held, (1) interest on a debt left owing, as opposed to a debt for money borrowed, cannot be deducted under section 23(1)(a) of the Income Tax Act but can be so deducted under the opening part of section 33(1) as one of the "outgoings and expenses wholly and exclusively incurred during the period by that person in the production of gross income from that source." In this case the source was the taxpayer's timber trade;

(2) the interest which is such an outgoing or expense would nevertheless be disallowed if it was caught by section 39 of the Act. It was not so caught in this case and therefore it is not disallowed by section 39(1)(g);

(3) the question of what the statute means by "interest" is a question of law. In this case the facts were not disputed either by the taxpayer or the learned judge. They accepted that the finding of fact is not subject to appeal but in this case it is not simply a question of fact;

(4) none of the matters raised was a question of fact on which the determination of the Commissioners was conclusive. All of them presented questions of law which are open to review by the court on appeal, the facts being agreed to by the parties before the Commissioners;

(5) the learned judge was right in this case in holding the deduction should be allowed for the interest payments and the appeal must be dismissed.

Cases referred to:

(1) *Salomon* v. *Salomon & Co. Ltd.* [1897] A.C. 22; [1895-99] All E.R. Rep. 33.
(2) *Chu Lip Kong* v. *DGIR* [1982] 1 M.L.J. 235.
(3) *Edwards* v. *Bairstow & Harrison* [1956] A.C. 14; [1955] 3 All E.R. 48; (1953) 36 T.C. 207.
(4) *Bombay Steam Navigation (1953) Pte. Ltd.* v. *Commissioner of Income Tax, Bombay* (1965) 56 I.T.R. 52
(5) *Commissioner of Income Tax* v. *Rohtas Industries* (1968) 67 I.T.R. 783.
(6) *State of Madras* v. *Thiru Arooran Sugars Ltd.* (1965) 55 I.T.R. 307.
(7) *DGIR* v. *L.T.S.* [1974] 1 M.L.J. 187.
(8) *DGIR* v. *L.D.T. Sdn. Bhd.* [1978] 1 M.L.J. 203.
(9) *L.D.T. Sdn Bhd* v. *D.G.I.R.* [1981] 2 M.L.J. 97.
(10) *State of Madras* v. *Coelho* (1964) 53 I.T.R. 186.
(11) *Re Martin* (1916) 33 W.N. (N.S.W.) 7.
(12) *Ben Odeco Ltd.* v. *Powlson* [1978] 2 All E.R. 1111.
(13) *Hudson's Bay Company* v. *Thew* 7 T.C. 206.

FEDERAL COURT.

Mokhtar bin Haji Sidin, Senior Federal Counsel (*Nor Azman* and *Edward Chia* with him) for the appellant.

Andrew Park Q.C. (*John Kah* and *Alex Decena* with him) for the respondent.

Lee Hun Hoe C.J. (Borneo) (delivering the Judgment of the Court): This is an appeal by the Revenue against the decision of the learned Judge in reversing the determination of the Special Commissioners in respect of the deduction of interest. The question arose on the assessments to income tax made on the Taxpayer for the years of assessment 1972, 1973 and 1974. The Taxpayer was assessed on November 16, 1974 as follows:–

Year of Assessment	Original or Additional	Income Tax $	Timber Tax $	Development Tax $
1982	Additional	1,613,701	391,311	192,377
1973	Additional	1,637,074	344,728	204,104
1974	Original	9,434,895	3,270,544	1,172,041

The Taxpayer claimed the following deductions:–

Year of Assessment	Forest Allowance	Interest
1972	$20,832	$12,273,971
1973	$18,759	$17,560,000
1974	$31,812	$24,253,426

The Special Commissioners allowed the deductions for forest allowance and there was no appeal on this. However, they rejected the deduction for interest and each gave his own reason. The learned Judge disagreed with them and gave his reasons for doing so. He allowed the appeal and ordered the assessments to be adjusted accordingly.

Mr. Mokhtar bin Haji Sidin appeared with Mr. Nor Azman and Mr. Edward Chia for the Revenue. Mr. Andrew Park, Q.C. appeared with Mr. John Kah and Mr. Alex Decena for the Taxpayer.

The Facts

As to the facts we need only to recapitulate some of the main features. The Sabah Foundation ("the Foundation") was established in 1966 under the Sabah Foundation Enactment, 1966 with the laudable object of promoting education amongst and encouraging the various cultures of the people of Sabah. It was managed by a chairman and eight trustees. By the Sabah Foundation (Amendment) Enactment, 1971, which came into operation on February 16, 1970 "the Foundation" was empowered to carry on commercial and industrial activities and to establish from time to time a corporation to carry out such activities. The amendment also gave "the Foundation" the right to apply and to acquire timber concessions and to work the same either directly or through contracting out. On December 28, 1970 the Chief Minister granted "the Foundation" a large timber concession of approximately 3,000 square miles by entering into a Licence Agreement ("principal agreement") with "the Foundation" pursuant to section 15 of the Forests Enactment, 1968. By an order made on July 7, 1969 under section 123 (3)(b) of the Income Tax Act, 1967 the Federal Minister of Finance granted "the Foundation" tax exemption for six years effective from year of assessment 1968. The Taxpayer is one of the companies incorporated by "the Foundation" as a wholly-owned subsidiary to carry on the timber trade.

Before the Special Commissioners the parties submitted the following Agreed Statement of Facts:–

1) Rakyat Berjaya Sdn. Bhd. (hereinafter referred to as "the company") was incorporated on September 8, 1970.

2) The registered office of the company is at Block K, Sinsuran Shopping Centre, Kota Kinabalu, Sabah.

3) On January 18, 1971, the company entered into an agreement with the Sabah Foundation for the assignment to the company of all its rights and liabilities under a Licence Agreement dated December 28, 1970 between the Government of Sabah and the Sabah Foundation.

4) The consideration payable by the company to the Sabah Foundation for the assignment was $250,000,000 payable by fifty biennial instalments, commencing from December 31, 1972, the first two of which was to be in the sum of $35,000,000 each and the remainder in the sum of $3,750,000 each.

5) The company was also required to pay interest at the rate of 7% per annum from the date of the agreement on the sum of $250,000,000 or such part thereof as was outstanding from time to time, but if default was made in paying any instalment, the rate was to be increased to 8% per annum.

6) In computing the income liable to tax for the years of assessment 1972 to 1974, the Director of Inland Revenue, Sabah has not allowed deduction for –

   1) interest paid in accordance with the assignment agreement; and

   2) forest allowances on the capital expenditure incurred on construction of the log pond and buildings (on the grounds that the company is not the licensee).

7) Assessments were made on the company on this basis on November 16, 1974."

At the relevant time the Chief Minister was also the Minister responsible for natural resources (including forests). As such, he was empowered to grant timber licences. He was also the Chairman of the Board of Trustees of "the Foundation" as well as the Chairman of the Taxpayer. We shall refer to the agreement between "the Foundation" and the Taxpayer as the "subsidiary agreement".

The Statutory Provisions

The opening part of section 33(1)(italicised) and section 33(1)(a) of the said Act are important and relevant. Another important provision is section 39(1)(g). The relevant provisions are set out below:–

"33.(1) *Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source,* including –

(a) subject to subsection (2), any sum payable for that period (or for any part of that period) by way of interest upon any money borrowed by that person and –

(i) employed in that period in the production of gross income from that source

. . . . . .

. . . . . .

(2) Where a person, being a person to whom subsection (1)(a) applies in relation to gross income from a business of his for the basis period for a year of assessment and in relation to borrowed money, has made (otherwise than for the purpose of producing that gross income) any loan of money or any investment in movable or immovable property, and the loan or any part thereof is outstanding at any time in that period or the investment or any part thereof is held by him at any time in that period and it appears to the Director General that the loan or any part thereof or the investment or any part thereof has been financed wholly or partly or directly or indirectly out of the borrowed money –

(a) the total sum payable for that period or any part thereof by way of interest on that borrowed money shall be deemed to accrue evenly over that period or part thereof, and so much of that sum as is thus found to accrue during each calendar month shall be taken to be the monthly figure for the purposes of this subsection:"

"39.(1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of –

. . . . . .

(b) any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of producing the gross income;

(c) any capital withdrawn or any sum employed or intended to be employed as capital;

. . . . . .

(g) any sum, by whatever named called, payable (otherwise than to a State Government or with the approval of the Minister, a statutory authority, or other body the capital or fund of which is wholly or substantially owned by a State Government or a statutory authority) for the use of a licence or permit to extract timber from a forest in Malaysia;

. . . . . .

Question of Fact and Law

One main contention of the Revenue is that the learned Judge has interfered with the finding of the Special Commissioners by reversing the finding of facts on the payment of interest. The Special Commissioners were unanimous in disallowing interest. Each gave different reasons for his decision. The learned Judge had dealt with the decision of each Commissioner and we agree with the reasons he gave for disagreeing with them.

The learned Chairman Mr. James Loh had obviously done much research and given deep thought to the matters before him. But the central points of his reasoning are difficult to accept on the facts. He went too far when he stated that "the Foundation" and the Taxpayer were in reality one enterprise just because the Taxpayer was a wholly-owned subsidiary of "the Foundation" and the same individual was the Chairman for both. Further, he found that the "subsidiary agreement" was in reality a sham. If this purports to be a finding of fact it is unsupported and wrong. There is no indication whatsoever that any evidence was given to the effect that the "subsidiary agreement" was not intended to operate according to its terms. The accounts show that the timber operations were carried out by the Taxpayer and that the Taxpayer did pay, or provided for payment of, the amounts expressed to be due to "the Foundation". It is therefore not surprising that the Revenue would not support Mr. Loh but had to concede that the "subsidiary agreement" was not a sham. As the learned Judge correctly pointed out neither the Revenue nor the Taxpayer argued that "the Foundation" and the Taxpayer were in fact one enterprise. The reason is obvious. It would mean that the income of the Taxpayer became that of "the Foundation" and as "the Foundation" was exempted from income tax consequent-

ly no income tax would be payable. There is no evidence to show that "the Foundation" had waived the exemption granted to it merely by the incorporation of a wholly-owned subsidiary. The Taxpayer has never disputed its liability to income tax like any other business concern.

Mr. Loh had approached the matter on the basis that the "subsidiary agreement" was a sham and had advanced the theory of one enterprise. He had not considered whether the payment is an allowable interest within section 33(1)(a) or whether the payment should be disallowed under section 39(1)(g). As a matter of law his decision cannot be supported. It suffers from a number of fallacies and false conclusions; the authorities cited do not support the propositions sought to be derived from them. It is rather unfortunate that in a number of respects while he took a valid and correct premise he sought to derive from it a conclusion which does not follow and which is incorrect. For instance, he stated correctly that "the Foundation" did not need to form a subsidiary to carry out the timber operations. But his conclusion that there was no reality in the subsidiary formed to carry out the timber operations and the law does not recognise it as a separate entity to carry out its own transactions is clearly incorrect. Again, he stated quite correctly that the law recognises the economic reality that a parent company can ultimately control and direct the policies and actions of its subsidiary. However, his conclusion that the law does not recognise the validity of contracts made between the parent company and the subsidiary is certainly incorrect. He was also wrong when he concluded that the actions of the subsidiary are the actions of the parent company.

We do not propose to go into all the cases cited. Suffice to say we agree with the learned Judge that the cases cited by Mr. Loh do not support his propositions that "the Foundation" and the Taxpayer were in reality one enterprise and that the "subsidiary agreement" was a nullity. The learned Judge dealt with *Salomon* v. *Salomon & Co. Ltd.*[1] and other cases adequately.

Commissioner Mr. Saravanamuthu decided that the interest payments were disallowed by section 39(1)(g) because they were made for the use of the timber licence. He was very much influenced by the fact that the "subsidiary agreement" contained a clause prohibiting the Taxpayer from assigning the benefit unless consented by "the Foundation". The fact that the Taxpayer cannot assign its rights without the consent of "the Foundation" is in no way inconsistent with it having acquired the rights and with it owing "the Foundation" the price for them. It owed "the Foundation" a debt. The interest payments were in respect of that debt. He also did not go on to consider whether the interest is an allowable deduction within the meaning of section 33(1)(a).

Commissioner Tan Sri Lim Leong Seng disallowed the interest on two grounds. First, it was not deductible under section 33(1)(a) because the $250 million was not money borrowed by the Taxpayer and employed in the production of income from the source. Secondly, as the interest was payable for the use of the licence it was disallowed under section 39(1)(g). He accepted the fact that "the Foundation" and the Taxpayer were two separate entities and also the "subsidiary agreement" as valid. However, because of the close relationship of the two he thought that they had made such arrangement thereby creating an air of artificiality which came very close to saying that it was a sham. To this the Taxpayer says that there is nothing suspicious, artificial or otherwise unusual in a parent company and a wholly-owned subsidiary company making such an agreement between themselves even if the same individual is the Chairman of both. The Taxpayer distinguishes between (i) interest on money borrowed, and (ii) interest on debts arising in other ways, e.g. by credit being given for the outstanding purchase price of an asset as in this case. It agrees with the reasons given by Commissioner Tan Sri Lim on section 33(1)(a) but disputed his reasoning on section 39(1)(g). It is correct the Taxpayer says that only interest within (i) can be deducted under section 33(1)(a). It is also correct that the interest which this case is about cannot be deducted under section 33(1)(a). But the Taxpayer says the interest in this case can be deducted under the opening part of section 33(1).

It does not follow, as Commissioner Tan Sri Lim thought it did, that the interest in this case was paid for the use of the licence. The Taxpayer says that it was paid for being allowed credit thereby creating a debt of $250 million. The only consequence of the debt being for a purchase price left owing rather than for money borrowed is that the Taxpayer is entitled to deduct the interest, not under section 33(1)(a), but under the general words of the opening part of section 33(1), permitting the deduction of "outgoings and expenses wholly and

exclusively incurred ..... in the production of gross income from the source."

The Revenue says Tan Sri Lim has given the correct answer in line with the contention of the Revenue. That is to say the so called interest is really part of the capital payment or consideration in addition to the $250 million. The learned Judge disagreed and held that it was interest and not capital payment. The Special Commissioners gave independent opinions all based on questions of law. At the hearing an Agreed Statement of Facts was submitted to them. The Judicial Committee of the Privy Council has very recently emphasised that the Commissioners are bound by the contents of such an Agreed Statement and cannot simply repudiate them and substitute their own notions of what the facts might have been *Chu Lip Kong* v. *DGIR.*[2] The Privy Council drew attention to the error implicit in the Special Commissioners expressing as findings of fact statements which are in truth propositions of law. The case stated in this appeal is open to similar criticism in a number of respects.

Appeals from the decisions of the Special Commissioners in tax cases are made by way of case stated under the Income Tax Act, 1967 Schedule 5, paragraph 34. The paragraph states clearly that any appeal is on a question of law. Hence, pure findings of fact may not be challenged on an appeal. However, the court has clear and undoubted jurisdiction to reverse a decision on questions of law. The term "question of law" includes the correctness of (a) pure statements of law (e.g. as to the correct interpretation of a statutory provision), and (b) the inferring of a conclusion from the primary facts (where the process of inference involves assumptions as to the legal effect or consequences of the primary facts).

In *Chu Lip Kong's case*[2] the Privy Council reversed the Commissioners' decision on the ground that it was wrong in law. The approach is similar to that of the House of Lords in *Edwards* v. *Bairstow & Harrison,*[3] a case universally acknowledged as the leading authority on the distinction between questions of fact and questions of law. It was also referred to by the learned Judge. He was fully conscious of the critical distinction between questions of fact and law. He stated the position succinctly and accurately before citing a passage from the above case. At page 54 of the Appeal Record he reminded himself in the following words:—

"..... The power of the court to interfere is quite limited where the findings of the Special Commissioners are basically findings of facts. The court will interfere only if there is no evidence to justify the finding or where they have applied erroneous tests in arriving at their conclusions or have drawn a wrong inference on the facts or have misdirected themselves in law ....."

He was quite aware that he had no power to reverse a Commissioner's decision on grounds of fact when he held that the Commissioner's decision was incorrect in law and should be reversed.

Commissioner Tan Sri Lim considered that the interest was not interest on money borrowed, therefore was not allowable under section 33(1)(a) and also that the interest was not allowed as a deduction under section 39(1)(g). This is not a finding of facts but rather a process of legal reasoning based on the interpretation of statutory provisions. In response the Taxpayer made the point that a transaction of loan by which money passes is not the only way in which an interest bearing debt can be created. Such a debt can be created and frequently is created by a sale of an asset for a purchase price left outstanding. It is important to appreciate that the "subsidiary agreement" is trying to differentiate between principal instalments and the interest as the consideration for each is different.

The Taxpayer disagreed with the contention of the Revenue that if interest cannot be deducted under section 33(1)(a) then it cannot be deducted anywhere else. Hence, the Taxpayer attached so much importance to the opening part of section 33(1) (italicised). Section 33 is not exhaustive. Other sections also allow deductions, e.g. section 34(6) deals with deduction of salary. Both Commissioners Mr. Saravanamuthu and Tan Sri Lim disallowed interest under section 39(1)(g). They considered that the interest payment was in reality not an interest payment at all but a payment for the timber licence or concession to extract timber from the concession. On the other hand, the Taxpayer contended that the interest was not consideration for the use of the licence but for using the credit. One can be indebted to another without money passing. The Revenue says that the interest is part of the selling price. The appellant disagreed with such contention. Suppose the Taxpayer managed to get $250 million somewhere "the Foundation" would be happy to accept. In which case the Taxpayer would not have to pay interest to "the Foundation".

It is the Taxpayer's case that he pays in two ways, namely, (i) instalment payment and (ii) in-

terest not capital payment and not for the use of the licence but for the use of the credit. A debt can be presently payable. It can also be paid in future. This is merely a matter of arrangement. Under Clause 3 of the "subsidiary agreement" there is clearly a debt owed by the Taxpayer.

We think the learned Judge was right to point out that when one assigns a timber licence under the Forest Enactment one assigns all rights and liabilities. Therefore, by assigning all its rights and liabilities under the "principal agreement" to the Taxpayer under the "subsidiary agreement", "the Foundation" must be taken to have assigned all its rights and liabilities. In other words, the Taxpayer has stepped into the shoes of "the Foundation".

Interpretation and Application of Statutory Provisions

No one disputes the contention that the deduction does not fall within section 33(1)(a) or any of the other paragraphs (b) to (d). Interest must be subjected to section 33(2). It must be used for the production of the gross income. The Revenue submitted that the learned Judge was wrong to rely on the Indian case of *Bombay Steam Navigation Co. (1953) Private Ltd.* v. *Commissioner of Income Tax Bombay*[4] to support his decision that the interest is deductible under section 33(1). It was pointed out that the Indian decision is merely persuasive and that our statute is entirely different from the Indian statute.

The Taxpayer agrees with the Revenue that interest does not come within section 33(1)(a). The only time it comes within section 33(1)(a) is on money borrowed. However, it is the contention of the Taxpayer, accepted by the learned Judge, that the opening part of section 33(1) (italicised) is the general rule which covers a multitude of expenses. The deductions are limited. However, it is submitted that such matters as telephone bill, water bill, electricity bill and so forth are covered by the general rule under section 33(1). In other words, if you have one item which does not come within section 33(1)(b), section 33(1)(c) or section 33(1)(d) it can still come within the italicised opening part of section 33(1). It is very important that the interest has to be incurred exclusively in the production of the gross income from that source, i.e. the timber trade. This is supported by impressive Indian authorities which, though not binding, are persuasive. In the *Bombay Steam Navigation case*[4] the company acquired various business assets for a purchase price, partly left owing and carrying interest at 6%. Section 10(2)(iii) of the Indian Income Tax Act, 1922 authorised deduction "in respect of capital borrowed for the purpose of the business ... the amount of the interest paid." The Supreme Court of India held that the interest paid by the company could not be deducted under that provision because there was no capital borrowed. However, section 10(2)(xv) permitted the deduction of:–

> "any expenditure not being an allowance of the nature described in any of clauses (i) to (xiv) inclusive and not being in the nature of capital expenditure of personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business."

The Court held that the interest was deductible under the above provision. The appellant submitted that the Indian section 10(2)(iii) corresponds to our section 33(1)(a) and section 10(2)(xv) to our section 33(1).

The arguments before us were also raised by the parties before the learned Judge. We need only say that we agreed with what the learned Judge said relating to the result at page 65 of the Appeal Record:–

> "The wording of section 10(2)(xv) (Indian Statute) is slightly different from our section 33(1) of the Income Tax Act but I think the effect is very much similar."

The Indian statute puts the general basket at the end whereas our statute puts it at the beginning. It makes no difference where one puts it – at the end or at the beginning so long as the result is the same. Unlike the Indian provisions our provisions have other baskets as well.

The *Bombay Steam Navigation case*[4] was followed by the Patna High Court in *Commissioner of Income Tax* v. *Rohtas Industries*[5] and by the Madras High Court in *State of Madras* v. *Thiru Arooran Sugars Ltd,*[6] a case on similar statutory provisions of the Madras Agricultural Income Tax Act, 1955.

Commissioner Tan Sri Lim misdirected himself by failing to appreciate that interest not qualifying for deduction under section 33(1)(a) can and in this case does qualify for deduction under the opening part of section 33(1).

The relationship between the deduction allowing provisions of section 33 and the deductions

disallowing provisions of section 39 is explained by Chang Min Tat, J., as he then was, in *DGIR* v. *L.T.S.*[7] To be deductible a payment must (i) be authorised as a deduction by section 33(1), and (ii) not be disallowed by section 39. The Taxpayer accepts that, if the interest payments were, as it contends, outgoings or expenses wholly and exclusively laid out in the production of income from its timber trade so as to comply with section 33(1), it would still fail to obtain relief if the interest payments were also caught by any of the disallowing provisions of section 39.

It is the contention of the Taxpayer that the interest payments are not disallowed by any of the provisions of section 39. On the other hand, the Revenue says the learned Judge was wrong to say that the interest payment is an allowable deduction as section 39(1)(g) is not applicable to the said payment. In support several authorities were cited, such as *DGIR* v. *L.T.S.*[7]; *DGIR* v. *L.D.T. Sdn. Bhd.*[8] upheld by the Privy Council in *L.D.T. Sdn. Bhd.* v. *DGIR.*[9]

Section 39(1)(g) is a unique provision under our Income Tax Act. We are not aware of any similar provision in the Commonwealth or elsewhere. This provision was specifically enacted to curtail unhealthy activity in the timber logging industry whereby a person is given a timber concession and he in turn gives away his rights under the concession to a third party for certain payment. The policy was to disallow the payment by the third party as a deduction in computing income of the third party. The provision was to implement that policy. It does not matter whether the payment is of a capital or income nature but as long as the payment is made for such right then the payment should be disallowed under that provision.

Section 39(1)(b) disallows "any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of producing the gross income." If we substitute the words "for the purpose of" for the word "in" the wording would then be the same as that of "the wholly and exclusively" test in section 33(1). On the basis that the Taxpayer's interest payments pass that test and are deductible under section 33(1) they will not be disallowed under section 39(1)(b).

Section 39(1)(c) disallows "any capital withdrawn or any sum employed or intended to be employed as capital." It is the statutory enactment of the undoubted general principle that payments of a capital nature are not deductible. It is the submission of the Taxpayer that this paragraph does not apply to the interest payments. It would apply to the payments of instalments of the principal debt of $250 million. That debt was incurred by the Taxpayer on capital account, and payments in reduction of it are capital payments. However, the payments of interest are quite different. They are not part of the consideration given by the Taxpayer for its purchase of the licence, a capital asset. They are consideration for the credit given by the Taxpayer for the outstanding debt. They are paid on a debt of a capital nature, but they are themselves payments of a revenue nature.

Interest is inherently an income expense of the payee, just as it is an income receipt of the recipient. It is payable at recurrent intervals. One year's interest is paid for one year's credit. Thus, one year's interest is the income cost of the use of one year's credit in just the same way as one year's rent is the income cost of one year's use of a company's business premises. Interest is a revenue expense, even if the principal debt on which it is paid was incurred to acquire capital assets and may be owing for a long time. Thus, in *State of Madras* v. *Coelho*[10] the Supreme Court held that the interest on the loan to buy the plantation (plainly a capital asset) was revenue expenditure. Interest was also allowed in the Australian case of *Re Martin.*[11]

Section 39(1)(g) disallows "any sum by whatever name called, payable ... for the use of a licence or permit to extract timber from a forest in Malaysia." It is an important provision because it was the basis on which two of the Special Commissioners decided against the Taxpayer. The contention of the Taxpayer is that the provision does not and cannot apply to the interest payments and that the two Commissioners are in error because they failed to analyse carefully the rights and obligations of the Taxpayer under "the subsidiary agreement".

The Taxpayer says it made interest payments to "the Foundation" for the use of the credit. It did not make them for the use of the licence. It is true that the Taxpayer agreed to pay the principal sum of $250 million as consideration for the sale to it of the licence. However, it also agreed to pay interest as consideration for the credit given to it and for nothing else. Indeed, if the Taxpayer for any reason stopped using the licence it would still have to pay the interest to "the Foundation".

There are two English authorities which decide

to the effect that interest is not consideration for whatever asset the debtor acquires with the credit. In *Ben Odeco Ltd.* v. *Powlson*[12] the company paid interest on money borrowed to pay for an oil rig. It was argued that the interest was expenditure on the provision of the oil rig. The House of Lords rejected the argument. The interest payments were "expenditure on the provision of money to be used on the provision of plant, but not expenditure on the provision of plant." The other case was one of interest on credit given, not on money borrowed. In *Hudson's Bay Company* v. *Thew*[13] the company sold land on terms whereby part of the price was left owing and interest was payable on the debt. It was argued that the interest was a capital receipt, like the instalments of the basic price. Rowlatt, J., an experienced judge on tax cases, held that it was not capital. It was not rent either. It was simply "interest on unpaid purchase money". The decision that the interest was not rent is important in bringing home the point in our case. If the interest paid to the Hudson's Bay Company was not rent and therefore not payment for the use of the land, then without any doubt the interest paid by the Taxpayer to "the Foundation" was not payment for the use of the licence.

Conclusion

Since the event of income tax everyone is trying his best within the law to pay as little tax as possible. All kinds of schemes are thought of. No commercial person in his right sense is going to carry out commercial transactions except on the footing of paying the smallest amount of tax involved. There is nothing wrong at all for a company to organise their affairs in such a way as to minimize tax.

The issue is whether the law permits the deduction of the interest incurred by the Taxpayer. To decide the issue one has to study carefully not only "subsidiary agreement" but also the relevant statutory provisions. Like the learned Judge we accept as correct the proposition that interest on a debt for a purchase price left owing, as opposed to a debt for money borrowed, cannot be deducted under section 33(1)(a) but can be so deducted under the opening part of section 33(1) as one of the "outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source." In this case the source is the Taxpayer's timber trade. The interest which is such an outgoing or expense would nevertheless be disallowed if it was caught by section 39. It was not so caught in this case. Therefore, it is not disallowed by section 39(1)(g).

It is understandable that the Revenue did not rely on the opinions of Mr. James Loh and Mr. Saravanamuthu. Mr. James Loh's approach is very academic and if he is right it would lead to the conclusion that "the Foundation" and not the Taxpayer was liable to income tax. Mr. Saravanamuthu's view is too drastic. The fact that the Taxpayer cannot assign without the consent of "the Foundation" does not at all lead to the conclusion that the interest payments were not in reality interest but were instead payments for the use of the licence. Tan Sri Lim's interpretation of the law is wrong when he considered that if the interest was outside the description of section 33(1)(a) it must also be within the description of section 39(1)(g). Although the interest could not be deducted under section 33(1)(a) as it was not consideration for money borrowed it was deductible under the opening part of section 33(1) as it was consideration for credit given by "the Foundation" to the Taxpayer. The giving of credit is entirely different from the use of the licence. For that reason the interest is not disallowed by section 39(1)(g).

The question of what the statute means by "interest" is a question of law. However strong one may feel as to the facts one must remember the facts are for the decision of the Commissioners. The facts are not disputed either by the Taxpayer or the learned Judge. They accepted that the finding of fact is not subject to appeal. But in this case it is not simply a question of fact. None of the matters is a question of fact on which the determination of the Commissioners is conclusive. All of them present questions of law which are open to review by the court on appeal; the facts being agreed to by the parties before the Commissioners.

As to section 140 we need only say that it was not raised by the parties and relied on by the Revenue. The learned Judge need not have to refer to it. Suffice to say that if the Director-General wishes to invoke his power under the section then section 104(5) requires that "particulars of the adjustment shall be given with the notice of assessment."

For reasons given we consider the learned Judge was right. We would therefore dismiss the appeal with costs both here and in the court be-

low. The deposit is to be paid to the respondent on account of taxed costs. In respect of costs – certificate for two counsel.

Appeal dismissed.

Solicitors: *Jayasuriya Kah & Co.*

KIN NAM DEVELOPMENT SDN. BHD. v. KHAU DAW YAU

[F.C. (Salleh Abas C.J. (Malaya), Seah & Syed Agil Barakbah F.JJ.) August 24, 1983 & January 20, 1984]
[Kuala Lumpur – Federal Court Civil Appeal No. 23 of 1981]

Contract – Contract for purchase of land and house – Application for sub-division of land – Special condition imposed that portion of land reserved for bumiputra – Whether contract discharged by frustration – Building contracts entered into by person not proprietor of land – Issue not pleaded – Whether breach of rules affects validity of contracts – Housing Developers (Control and Licensing) Rules, 1970, rr. 11 & 17 – Contracts Act, 1950, s. 24.

Housing Developers – Contract for purchase of land and house – Special condition imposed that portion of land reserved for bumiputra – Whether contract discharged by frustration.

This was an appeal from the decision of George J. reported in [1983] 1 M.L.J. 335. The appellant in this case had proposed to develop two pieces of land in Kuantan into a housing estate. One of the pieces of the land belonged to him and the other belonged to a company, the Futo Trading Company. The appellant invited members of the public to book the lots and booking applications were signed. All the lots were booked before approval for conversion and subdivision of the land was obtained. When the appellant applied for conversion and subdivision, this was granted subject to the condition that a number of the lots should be reserved for bumiputra. The appellant decided not to build any of the houses and action was brought by some of those who had booked the lots claiming specific performance of the contract. At the trial the appellant contended that he was not liable as the booking did not constitute a binding contract and that even if it did so, the contract was rendered not only impossible of performance but also illegal by the imposition of the special condition. George J. overruled the appellant's arguments and gave judgment in favour of the plaintiffs in the case in the form of damages. The appellant appealed. On the appeal counsel for the appellant did not raise the issue whether acceptance of the booking constituted a binding contract between the appellant and the purchasers, (the ruling of the trial judge in this issue being unassailable).

Held: (1) to invoke the doctrine of frustration the appellant must show that the completion of every one of the contracts was in substance a different obligation from what had previously been agreed to, that is, a new agreement altogether. In this case the substance remained the same. Each of the contracts was and still is for the sale of houses which the appellant agreed to build. The special condition imposed by the Pahang State Government in no way changed the substance of the appellant's agreement with its purchasers;

(2) it was no defence for the appellant to say that the special conditions were completely unexpected because under the law the State Government could even refuse the application altogether. The appellant had no good reasons to expect that its application would be approved at all. As it took the risk so it must pay for it;

(3) in regard to the land owned by Futo Trading Company, there was a breach of the Housing Developers (Control and Licensing Rules, 1970) but the question whether non-compliance with the rules rendered the contracts illegal by virtue of section 24 of the Contracts Act was not pleaded by the appellant and there was no proper factual basis upon which a ruling could be made;

(4) in any case there is nothing illegal about the consideration or object of the contracts because they are only contracts for the sale and purchase of houses. The Rules therefore do not affect the validity or otherwise of the contracts which the developer has signed with the purchasers;

(5) the appeal must be dismissed and the ruling of the learned Judge that the respondents are entitled to damages only instead of specific performance confirmed.

Cases referred to:

(1) *Daiman Development Sdn. Bhd.* v. *Mathew Lui Chin Teck & Anor.* [1981] 1 M.L.J. 56.
(2) *Taylor* v. *Caldwell* (1863) 3 B & S 826; 122 E.R. 309
(3) *Davis Contractors Ltd.* v. *Fareham U.D.C.* [1956] A.C. 696, 729.
(4) *Jackson* v. *Union Marine Insurance Co. Ltd.* (1874) L.R. 10 C.P. 125

FEDERAL COURT.

D. J. Puthucheary (*K. Y. Foo* with him) for the appellant.

A. Ramanathan for the respondent.

Cur. Adv. Vult.

Salleh Abas C.J. (Malaya) (delivering the Judgment of the Court): This is an appeal from the decision of V.C. George J. arising out of the trial of a consolidation of seven civil suits, namely: Civil Suits Nos. 256, 237, 258, 259, 274, 263 and 257 of 1978.

The facts which are not in dispute are as follows: The appellant, a housing developer under Licence No. 232/72 issued on September 18, 1972, was proposing to develop two pieces of land in Kuantan into a housing estate to be known as Lucky Garden.